Telephony

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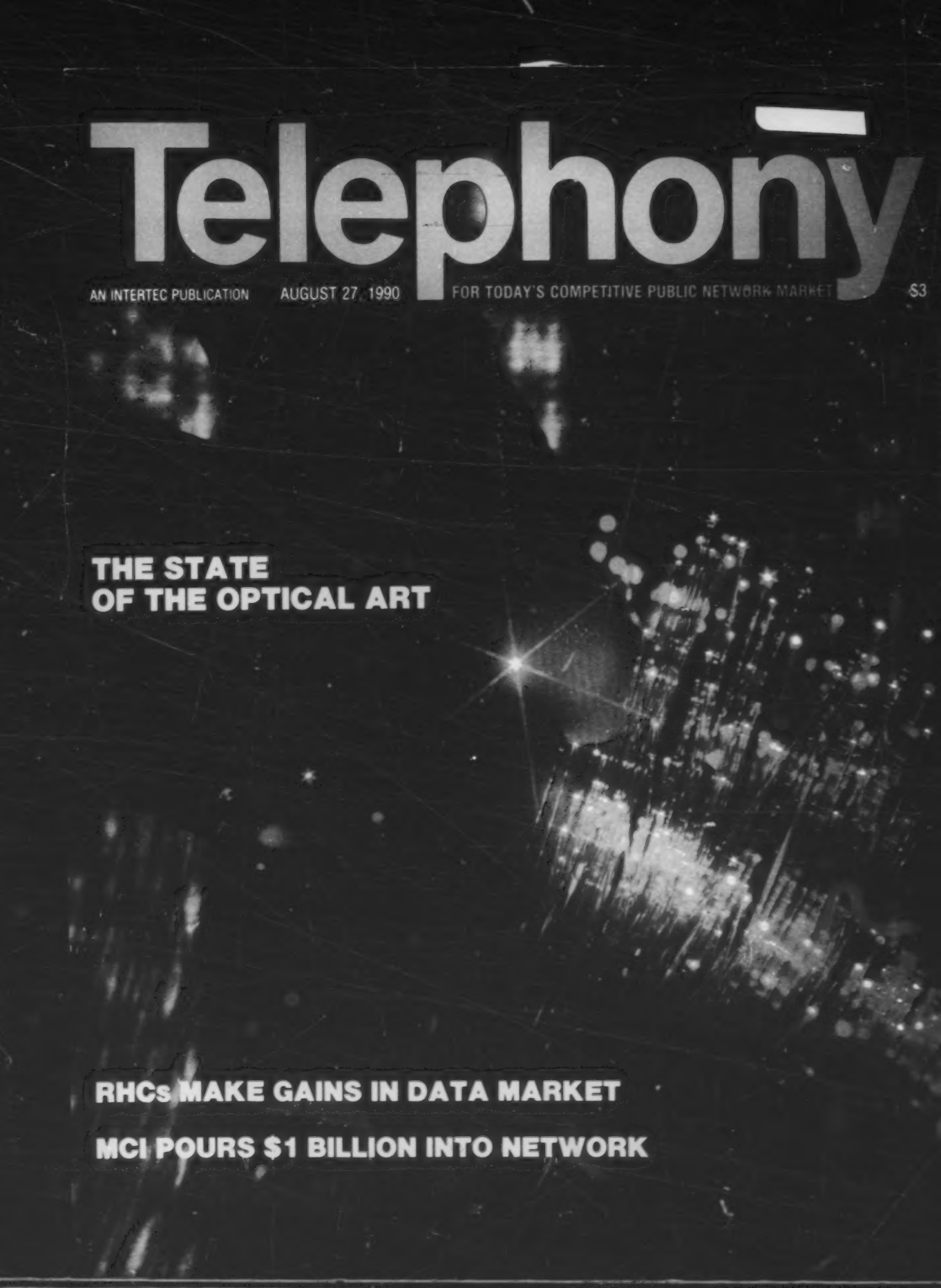

THE STATE OF THE OPTICAL ART

RHCs MAKE GAINS IN DATA MARKET

MCI POURS $1 BILLION INTO NETWORK

MONDAY, AUGUST 27, 1990 Volume 219, No. 10

Telephony

INTEGRATING VOICE & DATA COMMUNICATIONS

Research on fiber optics is nearing the point at which fiber cable will be as economical as copper. Researchers at British Telecom have helped to put a finger on the technology needed to get it there. Cover photography by Michael Stuckey, Comstock Inc.

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By Leslie A. Taylor. The Bell regional holding companies are no longer just telephone companies, and they're not information companies either. Thanks in part to Judge Greene, the RHCs are fast becoming international information companies

The world is becoming the RHCs' oyster

Regional is hardly an accurate description of the holding companies' setup to control the Baby Bells. Each one of the seven Bell regional holding companies has spread its wings and is flying high internationally

LESLIE A. TAYLOR

Telephone companies? Not exactly. Information companies? Getting closer. International information companies? Now you're getting the idea.

The seven Bell regional holding companies increasingly are taking their business experience and investment dollars overseas. Six years ago, following divestiture, these companies relied almost exclusively on revenues from local exchange service and telephone directories. Their domestic expansion opportunities were further limited by the Modified Final Judgment. Overseas expansion was much less restricted. It is not surprising, then, that the RHCs vigorously invested in numerous offshore ventures including cable television (CATV), cellular radio, computer consulting and personal communication networks (PCNs).

The RHCs are involved in at least 25 different activities in more than 36 countries. The diverse list includes traditional areas such as cellular and paging networks including the new PCNs, international fiber optic cables, packet switching, voice messaging and directory publishing.

It also encompasses less traditional endeavors: banking, including software, computer services, electronic funds transfer, and financial services; network design, engineering and management, and systems integration; computers and software; facility design, engineering and management; consulting and professional services, including international joint account management; and marketing, training, fundraising and publishing.

The RHCs also are taking advantage of opportunities in areas in which they are restricted in the United States, particularly CATV and information services.

The variety of endeavors reflects the diverse approaches of the different RHCs. Ameritech, Bell Atlantic and Southwestern Bell have approached international ventures cautiously, preferring to develop strategic relationships with overseas partners with ongoing multinational activities. The others—BellSouth, Nynex, Pacific Telesis and U S West—are involved in several ambitious international projects.

While most RHC activity has been in Western Europe and is likely to remain that way—except for expansion into Eastern Europe and the Soviet Union—the RHCs do have relationships and ventures all over the world (Table 1).

TABLE 1
WHERE ARE THE RHCs?

Argentina
Austria
Australia
Belgium
Canada
Caribbean nations
Colombia
Germany
France
Gibraltar
Hong Kong
Hungary
Italy
India
Israel
Japan
Korea
Malta
Mexico
Netherlands
New Zealand
Norway
People's Republic of China
Peru
Philippines
Singapore
Spain
Sweden
Switzerland
Taiwan
Thailand
United Kingdom
Soviet Union
Uruguay
Venezuela

Driving Forces

Domestically, the RHCs have recognized that the local loop is no longer the exclusive purview of the local exchange carrier and that only modest annual growth of about 5% can be expected in that area. Within the U.S., they have diversified as much as possible within the confines of the MFJ and U.S. District Judge Harold Greene's willingness to grant waivers.

This diversification is evidenced by the increasing portion of RHC revenues that are now derived from unregulated activities (Figure 1). In 1985, the RHCs derived an average of 14.4% of their revenues from non-telecommunications, unregulated activities; in 1989 an average of 21.47% of their revenues came from such services. The increased level of RHC investment overseas in the past four years, most of which has been in unregulated activities, is beginning to contribute to this figure and can be expected to make an even greater contribution in the future.

It will be four or five years, however, before many overseas ventures achieve the satisfactory levels of return—between 14% and 18% and higher—that the financial community wants to see. It will take this long because of the enormous capital investment required for new cable and cellular franchises and because of the RHCs' need to establish them-

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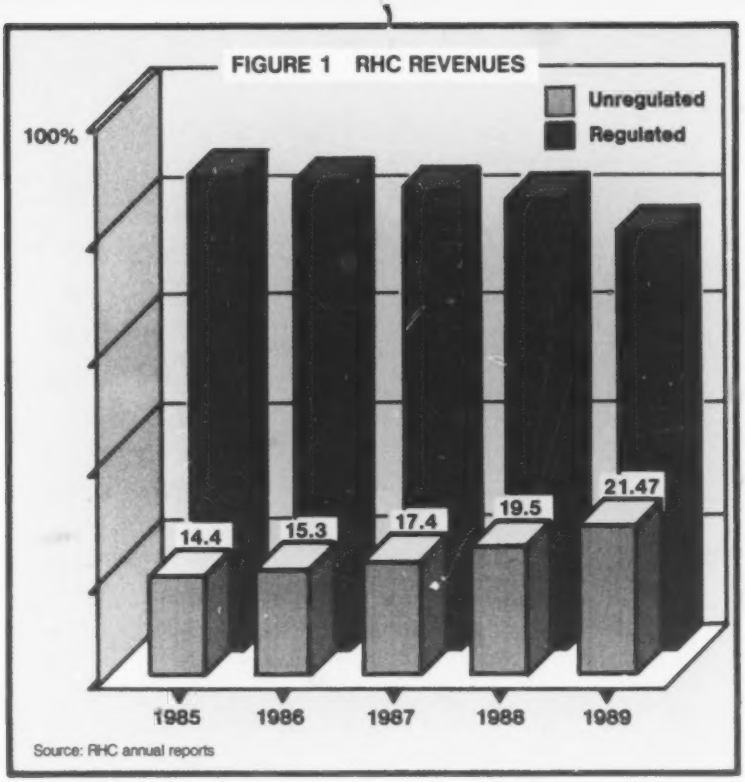

The RHCs' Oyster *continued*

selves in markets in which they are essentially unknown.

My recent study on RHC overseas investments came to the conclusion that the RHCs were "pushed offshore" by Greene's lack of flexibility with regard to domestic ventures compared to his willingness to permit the RHCs to pursue virtually any type of activity overseas.

Coincidentally, the RHCs were in the "right place at the right time," the study shows, as overseas administrations began to liberalize their approach to telecommunications and permit competition in the provision of certain services. Western Europe hastened the pace of deregulation with its decision to move to a unified economic structure by 1992.

They're Everywhere

Because worldwide CATV and cellular systems are a few years behind those in the U.S., the RHCs have been able to gain access to those markets at an early stage and in some cases have become major competitors of the established carriers.

TABLE 2 RHC OVERSEAS CELLULAR VENTURES

Country	RHC/Partners	Status
Argentina	BellSouth (54%), Motorola, Citibank, Socma, BGH, Astra	In service
France	BellSouth (4%), Compagnie Generale des Eaux, Nokia, Racal	In service
Hungary	U S West/Magyar Posta	Won license
Japan	Pacific Telesis/Metrophone	Bidding for second Tokyo system
Mexico	BellSouth, Sociedad Industrial Hermes, Banamex, Fabricas del Calzado Canada, Racal	Won license for part of country
Uruguay	BellSouth	Won license

In cellular, the RHCs are literally everywhere (Table 2). They already have invested more than $2 billion overseas, and there will be even more investment in the next few years.

The RHCs are getting the opportunity to practice the information and CATV businesses overseas away from close scrutiny of the U.S. market and U.S. competitors. Right now, the RHCs are banned from these businesses in the U.S. They're even getting experience in new services, particularly in PCNs, which are not yet available in the U.S. The RHCs' international experiences obviously will stand them in good stead if they are permitted to enter these markets in the U.S.

Apart from gaining actual experience in installing and operating these systems, the RHCs are learning more about joint ventures, partnerships and competition for government licenses and franchises. Some of their efforts during the past two years with regard to cable and cellular franchises demonstrate that the companies are on a learning curve. In many of the competitions, the RHCs have vigorously competed against each other, which has resulted, in some cases, in financial commitments that could reduce the potential for adequate financial returns.

In 1989 for example, West Germany conducted a competition for the franchise to build and operate a second digital cellular network to compete with the analog network already provided by Deutsche Bundespost. Ten international consortia competed for the license. In one of the first examples of RHC cooperation overseas, Ameritech and Bell Atlantic participated in the same consortium. BellSouth, Pacific Telesis, Nynex and Southwestern Bell all participated in separate consortia. Only U S West did not bid.

The winning consortium includes Pacific Telesis (with a 26% share), Mannesmann AG, Deutsche Genossenschaftsbank, Cable & Wireless, Lyonnaise des Eaux and the National Associations of Electrical and Automobile Trades. The investment is ex-

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pected to be between $1 billion and $2 billion over the next three to five years, and up to 350,000 subscribers are projected by 1995.

U.K. CATV franchises also have attracted heated competition among consortia that include several RHCs. Although most of the largest franchises were awarded before they came into the picture, the RHCs—as partners in consortia with both U.S. and foreign firms—have competed for the remaining franchises in London, its suburbs and less populated areas of the U.K. RHCs are involved in CATV systems serving 25% of the U.K.'s 15.4 million cable-accessible homes (Table 3).

One attraction of CATV franchises in the U.K. is that information services may be provided along with programming, affording additional opportunities for development of services and revenues. In France, however, where BellSouth is involved in CATV ventures, only cable programming is permitted.

Actions of the U.K. government may put a damper on the RHCs' flexibility to provide information and even telephony service through their cable systems. But the U.K. is undergoing a review of its shift several years ago to a duopoly in the provision of telecommunications services, and there are signs that British Telecom would like to see competitors somewhat less free to compete, particularly concerning what British Telecom regards as basic services.

TABLE 3 RHC CABLE SYSTEMS IN THE U.K.

RHC	System/Partner	Homes (000s)
Pacific Telesis	Masada	1390
	Jones Intercable	456
	Oyston	225
SW Bell	Oyston	225
Nynex (six franchises)	US Cable (Manchester)	915
	Cross Country/Comment	585
U S West	Cable Corp.	115
	Cable London	166
	London South	385
	West Country	385
	Comment Cablevision	355
	Cablevision Edinburgh	175
	Cablevision Birmingham	465
	United Artists	2000

It's Their Thing

Because the MFJ does not restrict the RHCs on operations completely outside the U.S., they are starting to get involved overseas in what they do best—providing basic telephone service. Bell Atlantic and Ameritech made a big splash this summer when they announced their intention to purchase a 49% share of New Zealand Telecom Corp. for $2.46 billion.

One smart reason for RHCs to buy interests in foreign telcos is to control both ends of the charges—and profits—on overseas phone calls. For now, this situation puts them on the other side of the deficit in U.S. settlement rates on overseas calling. Set by each foreign government, these high accounting rates have resulted in a deficit to U.S. carriers that has soared from $78.3 million in 1975 to $1.6 billion in 1988, according to a Federal Communications Commission report (Industry Analysis Division report of December 1989), mainly as a result of increased calling.

The FCC proposed extensive reform of the international accounting rate structure in July, but it will require cooperation by each foreign PTT to bring the accounting rate in line with cost.

If the foreign telecom infrastructure is sound—and this is a big "if"— these companies are potential cash cows for the RHCs. Such investments, however, are not without potential hazards. If Greene does not grant a consent decree waiver to Ameritech and Bell Atlantic to provide long-distance service between New Zealand and the U.S., it will cost millions of dollars to reorganize the long-distance operations. In addition, it will be more difficult for other RHC purchases to go through.

A number of other concerns have been raised within the industry and among regulators and users. Concerns center around the cost of these purchases; how these investments affect the domestic ratepayer (for example, possible cross-subsidization from regulated to unregulated activities and whether windfall profits are funding foreign acquisitions); and whether upgrading domestic networks and serving customers will be neglected for massive foreign projects.

With the fall of political barriers in Eastern Europe, the RHCs, not surprisingly, have offered their considerable expertise in telecommunications infrastructure. Because of the poor state of telecommunications in most of these countries, some are looking at cellular systems to create an "instant infrastructure." And the RHCs want to get their foot in the door to possibly provide basic phone service to such countries as Czechoslovakia, which currently has 12.5 phone lines per 100 people, and Hungary, with 6.2 lines per 100 people.

U S West has been awarded a contract to construct a 10,000-subscriber cellular network in Budapest, Hungary. A consortium that includes Bell Atlantic and U S West will construct a cellular system in Czechoslovakia. Along with a $60-million cellular investment, the two RHCs also will build a public switched packet data network for Czechoslovakia to help the Czechs modernize their antiquated telecommunications infrastructure.

Other RHCs are talking to various Eastern European administrations and the U.S. government, which is considering the easing of export restrictions to the former Communist bloc countries. COCOM, a 17-member export control group dominated by NATO countries, approves export of high-technology equipment to Communist

bloc and former Communist bloc countries. Relaxation of COCOM rules would open Eastern Europe to a variety of foreign enterprises.

Apart from CATV, cellular radio, private communication networks, computer consulting and technology transfer, three of the RHCs have sought involvement in international telecommunications facilities. Although Nynex was thwarted by Greene in its efforts to acquire an ownership interest in the PTAT private trans-Atlantic cable, Pacific Telesis was permitted to own up to 10% of the Japanese end of a private undersea Pacific cable. The cable is owned by Japanese-based International Digital Communications, a consortium that includes Pacific Telesis, C. Itoh, Toyota and Cable & Wireless.

In December 1989, U S West announced the formation of a consortium to build a fiber optic telecommunications line linking Japan, the Soviet Union and Europe. Its partners include the Soviet Ministry of Posts and Telecommunications and six other international telecommunications companies. The cable is expected to cost $500 million and take between three and five years to complete.

U S West is facing opposition from the National Security Agency, which prefers the current Soviet reliance on radio-based communications. In July, the U.S. Department of Commerce recommended denial of U S West's request to participate in the trans-Soviet fiber project.

Additional forays into international telecommunications facilities are likely as such facilities, including many privately sponsored ones, proliferate. Involvement in international facilities by the RHCs demonstrates their understanding of the rapid growth in international telecommunications (averaging 18% each year over the past five years) and a desire to strategically position themselves for the day when they may be able to re-enter the U.S. interexchange market.

The RHCs are becoming global companies. Even Ameritech, which has taken a cautious approach to international activities, established an international division in May with Andres Bande at the helm. Bande previously led U S West in its aggressive efforts internationally, which included in the past two years obtaining CATV franchises in Hong Kong, the U.K. and France. U S West also is in involved in one of the U.K. PCN consortiums.

What does this globalization mean? In the short term, it means a great deal of capital investment for the RHCs. The RHCs' international divisions are undoubtedly under a great deal of pressure to produce positive results since returns were less than stellar in 1989.

The internationalization of the RHCs ultimately will bring them new market and revenue opportunities and new learning experiences that will benefit ratepayers, shareholders and the American public. T

Leslie A. Taylor is a Telecommunications Consultant in Bethesda, Md. She recently completed the book *The RHCs: International Ventures, Strategies and Opportunities* for Phillips Publishing Co.

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